

## Budgeting and Return on Investment

When we want to predict our success in the HVAC business, we create a budget normally by looking at last year's sales. We tend to focus on sales and profits and may ignore our return on investment (ROI). Just because we sell a lot in 1997, and just because we earn \$25,000 in profits, does not make us successful. Two companies might pull in the same profit dollars but have decidedly different ROI's. Each and every year we need a return on our time, energy and monies invested in our HVAC company. If we couldn't turn \$1.00 into a \$1.25 or more, why would we want to be in business? Each year, at the end of our fiscal year, we have the opportunity (choice) to either liquidate our assets, pay off our bills and invest the difference in a bank at 3%; or continue in our HVAC business and try to earn an interest rate above 3%. That's why we stay in business — we know we can make more money in HVAC than at the bank. Said another way, our return on investment at the bank is 3% and our return on investment in our business

should be much more than 3%.

Return on investment is defined as net profit before taxes at the end of your fiscal year divided by your net worth at the beginning of the fiscal year.

Let's use an example to illustrate the formula.

Ben's Heating and Air Conditioning, Inc. showed a net profit before taxes on Dec 31, 1996 of \$17,000. Looking at the company's financials on January 1, 1996, we see a net worth of \$50,000. Dividing \$17,000 by \$50,000 equals 34%. Ben invested \$50,000 on January 1, 1996 in his HVAC business and received a return on his investment of 34%. His "investment" earned was his profit of \$17,000.

ROI will vary according to your salaries, compensation, and business type, but it should be at least 15% (I like for them to be closer to 25%).

ROI's for smaller companies tend to be larger because their net worth is smaller.

Calculate your ROI for 1996 then try to exceed it in 1997 with a well planned budget. IF  $ROI = NPBT / NW$ , THEN Desired ROI for 1997 x

Net Worth at beginning of 1996

= Needed Net Profit Before Taxes at end of 1997. Then, needed net profit before taxes at end of 1997 / Budgeted profit percent for 1997 = Budgeted Sales for 1997

This is an easy way to calculate sales budgets and net profit budgets for the new year and it really focuses your business on ROI. If you can earn an ROI of at least 25% you'll have little problems growing your company and your personal assets.

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